

Chap. 16 : industry and economic policies -- politics and the economy in a new nation (part ii. case-studies)

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journal or publication title	The Japanese Experience in Technology: From Transfer to Self-Reliance
page range	199-208
year	1990
URL	http://hdl.handle.net/2344/00050965

Industry and Economic Policies—Politics and the Economy in a New Nation

The Effect of Economic Policies

The question of why Japan succeeded in modernization with industrialization as the axis was one of common concern to the participants in our dialogue. One of our responses to this question was that, because Japan had not been colonized, it was possible for it to adopt a policy of development and to form a consensus regarding modernization. However, some expressed dissatisfaction with this answer, as several countries in Latin America had attained independence early in the nineteenth century. Brazil, for example, was one of the 10 richest countries in the world, but it was slow to industrialize. The problem is one of the "speed of industrialization." Thus, it is important to consider not only why but how modernization by means of industrialization was achieved. The starting point and process of modernization and industrialization and conditions that determined the structure, form, and pace of industrialization in Japan were subjects for discussion. The scale and composition of the national economy (resources, the market, etc.) and national society (population structure and its rural-urban concentration) are also important aspects to study.

Modernization or industrialization, or both, require a series of criteria, not the least of which is a sovereign nation; others include a high level of social integration, an efficient administration, social mobility, a market mechanism, political participation and mobilization, education and information systems, and a degree of secularization, to name some of the main ones. However, their mere existence is not sufficient either for modernization or for industrialization. At the end of the Tokugawa period, Japan was in a state of excessive, saturated equilibrium, which, with a proper impetus from the outside, was able to be changed quickly; without outside force this equilibrium would have remained.⁸⁰

The effect of continual international pressure on the domestic situation was

strong enough to arouse a sense of crisis but not enough to make people desperate: this provides the best condition for the promotion of modernization in a late-comer country. As Sato (1977) has observed, the international environment for modern Japan was generally close to the optimum. And, Japan's geopolitically advantageous position was used to good effect.

The atmosphere of national crisis was heightened by three chief factors, namely, the remote distance from the Western powers and the concomitant uncertainty as to the full extent of the West's military and economic might; China's example in the Opium War—for more than 1,000 years China had been a model for the formation and development of national culture—an example of what could happen when a country rejected the demands of the Western powers to open its doors; and a greater danger of Japan's sovereignty being threatened even by China. Consequently, a national consensus for Japan to model itself after strong nations to cope with them was formed relatively easily.

There has been the expectation in some quarters that, through the generalization and theorization of Japanese historical and particular national experiences and the conditions that enabled it to attain an "industrial revolution," it would be possible for other late-comer countries to initiate their own industrial revolutions. Conditions are different for each country, some created intentionally, others occurring heteronomously; yet, even if we could generalize or theorize, we would not be free from an uneasiness that the conditions we might isolate would not be concrete or effective.

However, that Japan could industrialize proves that other countries can too. For this reason, we established our project to study the development and technology related to each specific industry, to provide positive and negative evidence, a general, inclusive prescription, embracing elements common to all industrializing countries, in order to help these countries work out feasible measures for national development.

An industry-centred approach such as ours has its merits, but it also limits the range and relevance of the problem and tends to fractionate it. For this reason, it was necessary to command a bird's-eye view of all the relevant areas. This was why we set up a subproject to study economic policies.

But why study the age of Matsukata fiscal policy of a century ago? To answer by way of conclusion, the period of the Matsukata fiscal policy was one in which a new nation-state faced a grave crisis. Internally, it was a great turning point. The sovereignty of a nation can depend not only on how military and political problems are handled but also on how the national economy and finances are treated.

A good example of how serious an effect a loss of sovereignty in the economy and finance can have is provided by the fate of the Muhammad Ali dynasty in late-nineteenth-century Egypt. This great power, at the time so much richer and more powerful than Japan, was often said to be the sole power in the orient comparable to the great powers in Europe. Yet it was colonized because of its failed financial policies (excessive loans). Its finances were administered by Great Britain and France, which had adopted con-

flicting financial policies, the two powers then withdrew their support and Egypt lost all the achievements of modernization it had attained.

Two Opposing Lines, Radical and Conservative

The political change of 1881 (the fourteenth year of Meiji) was the outcome of a confrontation in the selection of policy lines regarding how to overcome the financial crisis faced by the new government. The choice was between a positive measure based on loans (foreign bonds) and a retrenchment policy; the latter was adopted.

From the standpoint of industrialization, this action meant the change from a positive and extensive introduction of Western technologies to the protection and maintenance of traditional technologies (and their modernization). It was also a shift of course from a government-led industrialization policy to the promotion of private businesses, from centripetal to centrifugal tendencies, and a change in emphasis from industry to agriculture. It was also a shift of political power from political-activist-type politicians to administratively oriented politicians. It was a period in which political and ideological confusion yielded to economic and social adjustment. Domestically and internationally, the destiny of the new government depended on such adjustments.

Obviously, the successful treatment of economic and financial problems requires experience and knowledge, and at the end of the Tokugawa era and during the Meiji Restoration in particular, an informed view of the international economy was essential. Fortunately, Japan had a quarter-century after the opening of the country until the consolidation of the Meiji Restoration during which economic and finance specialists could be cultivated. Shibusawa Eiichi, Matsukata Masayoshi, and Maeda Masana are representative. Okuma Shigenobu played an important role in the new government with his expertise in international law. As minister of finance, he handled such internationally important matters as loans from foreign countries initiated by the shogunate government and feudal clans.

Although such talented men were available to the new government, not all were always provided with places and opportunities to play active roles. Though some economic problems were important issues that had critical bearing on Japan's international politics and diplomacy and constituted, in terms of domestic politics, the basis for the stability of the government, they were eventually only part of the whole system of policies.

Each feudal clan had a bureaucracy in charge of economic and financial policies that could exercise a certain amount of power in relation to development problems. Indeed, the policy of promoting industry, the keystone in the Meiji government's economic policy, was an extension, on a nation-wide scale, of what Yokoi Shonan (1809–1869) and others had done successfully in the feudal Fukui domain.

With the opening of the country, both the shogunate government and the

various feudal clans immediately lost their financial equilibrium. As studies in economic history have revealed, from the beginning of the nineteenth century, economic and financial problems began to be experienced in each feudal domain. Faced with the dilemma of having to select either an economic development policy that might undermine the feudalistic basis of the social system or a policy of stability through financial retrenchment, the clans individually conducted international economic relations with the various foreign powers.

Each clan had developed its own specialties and a nation-wide market had been formed with Osaka as its centre, and the economic bureaucrats (who were also samurai warriors) had been trained in this system. The opening of the country, however, forced the shogunate to undertake the construction of new port facilities and arsenals and the purchase of warships. Further, the shogunate could not maintain sovereignty with the 80,000 warriors and economic capacity of 8 million *koku* of rice under its direct control, and it encouraged the clans to purchase big ships and other military equipment. This destroyed the monopoly of foreign trade, technology, and international information the shogunate had maintained with its military predominance and its closed-door policy. This also meant an unprecedentedly heavy financial burden for the clans.

The powerful clans in south-western Japan, namely, Satsuma, Choshu, Tosa, and Hizen, overcame the financial crisis, and many of the real power holders in the Meiji government were men from these clans. The Satsuma clan, well known for its benevolent leaders, had the good fortune to have men knowledgeable in fiscal matters during the critical period of the late Tokugawa era, and it was able to transfer the modern technology necessary to reinforce its armaments.

The clan was in the extreme south-western area of Japan, far from the nation's political centre, and smuggling from China and other areas—facilitated by the remoteness of the Satsuma borders—conducted in the guise of trade with Okinawa, also aided the Satsuma clan in achieving its aims. It was through these illicit trade channels that the clan secretly sent students to Great Britain. The clan also had a special young men's organization established to train a political élite to strengthen the clan, and the ties formed among these young men reappeared in later days as personal connections and factions in the Meiji government. (Robert Baden-Powell took the Satsuma clan's juvenile organization to Great Britain, where it later became the Boy Scouts.)

The Satsuma and other powerful clans made full use of the symbolic authority of the Imperial Court to press the Tokugawa shogunate, the holder of political power, to expel foreigners from Japan. In union with power-minded court nobles, the clans gradually drove the Tokugawa shogunate into a corner, and the Satsuma and Choshu clans instigated an attack on foreigners. As soon as they realized, however, the little chance their swords had against the warships of the Western powers, the need of reorganization and modernization of their defence system became abundantly clear.

The reparations for the Satsuma and Choshu campaigns to expel foreigners had to be paid by the Tokugawa shogunate, but the cost was so high that the shogunate embarked on punitive measures against the Choshu clan for its rebellion against the shogunate government. The shogunate also restored government authority in the Emperor and attempted to manage international and domestic political problems through a united regime combining the Imperial Court and the shogunate. There was strong opposition by some of the clans, however, owing also to the shogunate's punitive actions. As a result, those opposed and those not were polarized into pro-shogunate and anti-shogunate factions, which resulted in a bloody civil war that raged for one-and-a-half years.

The battle started in Kyoto, extended to Edo, and finally a portion of the shogunate's forces retreated to Hakodate, in Hokkaido, where the final fight was waged. Through the manœuvring both by Great Britain, which changed its policy from one of neutrality and non-intervention into the domestic problems of another country to one supporting the new government, and by France, which supported the old regime, the fighting in Edo was minimized. That is, to protect their trade interests, both encouraged an end to the fighting.

The Tokugawa regime thus came to an end and a new government was installed. The new government had, as one of its first challenges, the problem of the liabilities of the old one. The total amount of these liabilities exceeded the government revenue for two years, and, except for the foreign liabilities, 80 per cent was written off. The biggest losses were suffered by the wealthy merchants of Osaka. As the notes the clans had issued became valueless, ordinary citizens were also plunged into confusion.

Another difficult problem was the samurai stipends. To transform the old regime into a nation-state, the new government forced the feudal lords to hand over their administrative powers and in their place appointed non-hereditary governors. This shift of power brought with it the burden of continuing the stipends to the samurai class. Although the new government greatly reduced the stipends to the pro-shogunate clans, the total of all payable by the government amounted to approximately half its annual revenue.

In an attempt to lessen the burden, the government recommended that the samurai class give up its hereditary stipend, and offered any samurai who would engage in business payment equal to an annual stipend for six years, on the further condition that he waive forever his and his family's stipend rights. An amount equal to a stipend of four years, partially in cash and the rest by government bond, was offered to those who waived their rights for the duration of their lifetime.

The income for the ex-samurai class thus was reduced to less than 30 per cent of what it had received at the end of the Tokugawa period. The ensuing poverty of this class—which had no means of earning a living—was worsened by the inflation that followed. It was under these economic conditions that the ex-samurai rebellions occurred in different areas of Japan in the latter half of 1870.

The commutation of feudal stipends was carried out by raising foreign loans that amounted to £2.4 million, which was indeed risky. During the age of gunboat diplomacy, Japan had no customs autonomy. Even the income at the Yokohama customs house had been turned over as security for a loan from Great Britain, which was used to liquidate a loan from France.

The new government required feudal lords to surrender their lands to Imperial control and to abolish their domains, which were replaced with prefectures. But many obstacles stood in the way. The lord of the Satsuma clan, for example, had been supporting a campaign by his retainers to overthrow the Tokugawa shogunate, intending to take over the shogunate from the Tokugawas. Despite his contributions to overthrowing the Tokugawa (in order that he himself could assume the shogunate), however, he received no special consideration from the new government, and, not surprisingly, offered no co-operation in the government's reform efforts. Indeed, most of the powerful clan leaders were excluded by the new government, which created a great deal of frustration and resentment, but they were powerless to change the situation.

Furthermore, although there was great dissatisfaction with the government's new policies, the clans' ability to resist had been destroyed by the worsened financial conditions. The leaders in the new government were lower-ranking samurai, men of practical experience who were quite capable of carrying out reforms. In this they differed greatly from the higher samurai class, which was made up of men generally much less competent.

A mere rearrangement of old customs, however, did not consolidate the financial foundation of the new government. For this reason, a land-tax reform policy was implemented. The source of revenue for the shogunate and the feudal clans had been a tax in kind, principally rice. The new government continued this policy, but, because establishing any stable financial programmes based on rice was difficult and because collecting a tax in kind was costly, a policy of collecting taxes in money was adopted.

The government initiated a four per cent tax on privately owned land, to be paid to the central government. After four years of efforts, the tax was implemented on a national scale in 1876. In the following year, the South-western Rebellion broke out, fruit of the antagonism that had been building within the political order. This rebellion was the last general rebellion by the ex-samurai class. The war created financial confusion, leading to currency instability and increased inflation.

The government had to cope with the chaos caused by the paper notes that had been issued in addition to the gold, silver, and other metal coins and the inflation that resulted. An effective policy thus required a firm stabilization and unification of the various currencies in circulation. Finance Minister Okuma proposed to solve the problem at one fell swoop by introducing foreign loans of £50 million. It is not known if there was a bank offering such a loan. It might have been a political tactic on Okuma's part, or there might have been a bank with which he was negotiating. In any event, it was, indeed, a bold policy. Once the land-tax reform had been accomplished, the govern-

ment could undertake financial planning. Though the reform was advantageous, the cash income it brought the government was not effective against inflation (Umemura 1983).

Contrary to Okuma's predecessor, Inoue Kaoru, who was forced to resign following his unsuccessful attempt to persuade his military and education ministers to accept scaled-down budgets, Okuma resigned as minister of finance—a post he had occupied for seven years—because his policy was seen as being dangerously bold.

Matsukata, who succeeded Okuma, adopted a deflationary policy in which a revision of the public accounting system's mechanism of revenue increase and a tax increase were combined. He succeeded in ending speculation in rice by altering the tax collection schedule such that tax payments were due immediately after the harvest. In this way, the financial block was overcome and the inactivity of exports and the attempt to increase imports improved. Thus, the foundation of modern finance was consolidated (Muroyama 1983).

The members of our research team analysed the financial problems faced by the new government from an international point of view, in terms of the global political and economic conditions of the time. This is a departure in the sense that there has been a tendency to exaggerate the value of Matsukata's financial programme; viewing a policy like Matsukata's from an international perspective makes possible a better understanding of what role financial problems (especially foreign loans) play in development and of the importance of maintaining a proper balance between international conditions and internal needs and conditions.

Japanese success was ensured especially by the policy of encouraging industry that was in effect in the period after the Matsukata deflationary policy, which induced a balanced development of the new and old sectors by promoting the development of traditional and local industries.

Maeda Masana conducted a nation-wide industrial survey (in the mid-1880s) and made its results the basis of a development plan published as *Kōgyō iken* (Industrialization policy).⁸¹ He criticized the policy centred on the machine industry as one of the "wrong order," and recommended the development of "native industry." Maeda and his policy line lost in the bid for leadership, and he left government service. He toured various regions, advocating that each village, town, and prefecture should establish its own guide-lines for improvements of agriculture and local industry.

Beginning in the 1890s, the Ministry of Commerce and Agriculture became active in the improvement of animal and plant breeds, of land, and agricultural technology. The full-scale development of agricultural administration had begun.

As a long-term trend, the Japanese economy began to follow a path of slow growth after the turn of the century. The agricultural industry had been the basis for growth before the opening of the country; due to an extraordinary increase in government expenses after the opening of the country, however, the government was forced to remint coins and accept loans from wealthy merchants, all of which led to serious inflation.

As Japan adopted a silver standard in which its price was set higher than on the international market, importing silver and exchanging it with gold yielded a value that represented sometimes a threefold increase. This brought on a great outflow of gold. The government reminted the coins to match the international standard, but was forced to stop under pressure from foreign countries. In response, the authorities maintained the price of silver, while raising the price of gold by three times. Thus the government effected an international equilibrium at the sacrifice of domestic economic balance. The result was confusion that eventually overcame the Meiji government.

In the period 1872–1884, of the approximately ¥54 million that was reminted, around ¥43 million flowed out and only some ¥11 million remained in Japan. The new government failed in its currency policy, but it was an inevitable reality brought about by the unequal treaties (Nakamura 1983).

The decision on either an overall disposal by means of a foreign loan (Okuma) or a deflationary policy became a political issue. Umemura (1983) states that Okuma's foreign-loan policy had as part of it a cleverly hidden increase of state revenue in real terms of approximately 50 per cent as a result of a currency reform involving a shift to tax payments in cash rather than in kind. Thus the new view arises that deflation had already been progressing in the Okuma era and was accelerated by Matsukata.

In Okuma's policy, inflation was attributed to the sharp increase of the price of gold, and the measure for overcoming it was an overall substitution of currency with specie and the promotion of production on an enlarged scale. Yamamoto (1983) concludes from this that Okuma was an advocate of a policy of promoting industry, but he casts doubt on the possibility that such a large loan could ever have been repaid.

Under rapidly worsening inflation after the Southwestern Rebellion, some influential politicians and businessmen insisted that commodity prices be stabilized by restoring the payment of taxes in rice and by providing the government with the function of adjusting the price of rice. Inoki (1983) points out that the government was reluctant to change to a policy of taxation in kind, as it was believed this would intensify the civil disturbances occurring at the time.

At the time, the land tax provided 76 per cent of tax revenue. To coincide with rice cropping, the tax was scheduled for payment in late autumn or spring. Yet, because expenditures were being made continually, it was inevitable for the system to borrow temporarily more than ¥10 million every year. In 1880, these temporary loans amounted to a third of the national budget. Matsukata regarded this as a good reason to lower the value of currency, and he put into effect a minor technical change regarding the period for tax collection that helped bring about an increase in tax revenue and a reduction in expenditures (Muroyama 1983).

A comparison of financial surpluses between the Okuma and the Matsukata periods will verify that they were about the same. In Matsukata's, it was disposed of by transferring the burden to local finance. Although the rice speculation boom, a kind of business cycle, overlapped with the Matsukata

deflation, the conclusion is that Matsukata should not have adopted a deflationary policy. Teranishi (1983) states that military and political exigencies forced Matsukata to make adjustments in his policy intention to reduce the scale of the budget.

Local Development

Saito Osamu (1983) has shown how an increasing importance was being attached to traditional industry in the government's policy of encouraging industry, in accordance with its shift from an emphasis on the prevention of imports to one of the attainment of international balance of payments. He also points out that in this process, the local governments had great latitude, although they depended on financing from the central government. In road construction, for example, the ratio of expenditures between the central and local governments was one to two. The Matsukata financial policy provided an opportunity to equalize the shares of the central and local governments in the expenses budgeted for government projects.

Abe (1983) breaks down the changes in traditional industry (e.g. cotton weaving) into (1) revival, (2) decline, and (3) growth, and concludes that a regional division of labour and local specializations were decisive factors. These factors made possible continuous and expanded operations. Enforced uniformity in production was also critical. For example, in Sennan (Osaka), the use of imported yarn for the warp threads beginning in 1875 and the invention of a weaving machine increased productivity two and a half times, and the products of this area outrivalled those from other areas. However, at the time the Matsukata deflationary policy was being implemented, to adjust to a shrinking market, some manufacturers began mixing inferior threads with the imported threads to reduce their prices. This practice eventually damaged the reputation of Sennan cloth, which, in turn, gave rise to the formation of local wholesalers' associations that enforced standards throughout the entire area. Sennan's reputation was thus restored.

An example of a declining trend is Niikawa (Toyama Prefecture). This was a cotton-processing area, and the spinning machine spelled its defeat. The producers in this area were indifferent to technological change and tended to ignore the need to make adjustments to accommodate changing market conditions. In areas that experienced growth, on the other hand, machines were introduced early and the conversion from producing simply white cotton cloth to producing patterned cloth using pre-dyed yarns, in line with a changed market, was carried out successfully. Growth was often characteristic in areas that began business after the Meiji Restoration. Even under the Matsukata deflationary policy, these areas developed new markets in the Kanto and Tohoku areas and continued their growth.

How were these domestic situations linked with the international economy of the time? Japan was already a part of the world business cycle at the time of the Matsukata deflationary policy, and the price of commodities in Japan

was affected by world fluctuations. While the world trend was deflationary, Japan was experiencing inflation, which allowed for high economic growth. The period of recovery was accompanied by a drop in foreign exchange linked with the fall of the price of silver. Aided by the growth of exports and by the recovery of overseas business and low exchange rates, Japanese enterprises experienced significant growth.

With the Matsukata financial policy as a turning point, the relations between agriculture and industry changed from one with a leading role taken by agriculture to one of parallel growth.